



CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

June 9, 2004

S. 1508

Federal Housing Enterprise Regulatory Reform Act of 2004

*As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs
on April 1, 2004*

SUMMARY

Enacting S. 1508 would establish a single regulator—the Federal Housing Enterprise Supervisory Agency (FEHSA)—for government-sponsored enterprises (GSEs) concerned with home mortgages. GSEs are privately owned, Congressionally chartered financial institutions created to enhance the availability of credit in the economy. The GSEs that would be regulated by FEHSA under the bill include the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks (FHLBs). These GSEs were created to increase the availability of credit for home mortgages. FEHSA would be an independent agency within the federal government, and it would have authority to oversee the safety and soundness and the housing mission of these GSEs.

Beginning in 2006, CBO estimates that implementing this legislation could affect direct spending as a result of the collection and expenditure of mandatory fees charged to these GSEs by FEHSA. However, CBO estimates that those transactions would have no net significant effect on the federal budget because we expect that such fees would mostly be spent by FEHSA in the year in which they are collected. The amounts collected and spent could total as much as \$100 million each year. (By comparison, oversight of the housing GSEs currently costs about \$75 million a year, with most of that cost funded by fees charged to the GSEs.)

In addition, CBO estimates that implementing S. 1508 could, beginning in 2006, result in savings of about \$5 million annually, subject to appropriation actions consistent with this estimate. These savings would result from the new fee mechanism that would be established under this legislation that would replace the use of appropriated funds.

S. 1508 contains intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the resulting costs would not be significant and would not exceed the threshold established in UMRA (\$60 million in 2004, adjusted annually for inflation).

S. 1508 would impose several private-sector mandates as defined in UMRA on Fannie Mae, Freddie Mac, and the FHLBs. CBO estimates that the aggregate direct cost of those mandates would exceed the annual threshold established by UMRA (\$120 million in 2004, adjusted annually for inflation) in each of the first five years the mandates are in effect.

ESTIMATED IMPACT ON THE FEDERAL GOVERNMENT

CBO estimates that enacting this bill would have no significant net budgetary effect because the amount of fees FHESA would collect would mostly be spent in the year in which the fees are collected. In addition, any impact stemming from the penalties that could be assessed under this bill would most likely be insignificant.

BASIS OF ESTIMATE

Currently, the Department of Housing and Urban Development (HUD) is responsible for setting affordable housing goals for Fannie Mae and Freddie Mac and ensuring that these two GSEs meet such goals. HUD's oversight activities are funded from the agency's annual appropriation. (In 2003, HUD spent about \$5 million to perform those oversight responsibilities.) In addition, the Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency within HUD, currently oversees the financial safety and soundness of these two GSEs. OFHEO is funded through annual assessments collected from Fannie Mae and Freddie Mac, and the collection and spending of these assessments are subject to appropriation. In 2004, OFHEO was authorized to collect and spend about \$40 million to perform its duties.

The FHLB system, which consists of 12 regionally based banks, is currently regulated by the Federal Housing Finance Board (FHFB). The FHFB is an independent agency that oversees the financial safety and soundness of the FHLBs as well as its mission compliance, and it is funded through annual assessments collected from the earnings of the FHLBs. The collection and spending of these annual assessments are not subject to appropriation. In 2004, the FHFB anticipates that assessments and spending will total about \$30 million.

Under S. 1508, FHESA would be divided into three separate divisions. One division, the Office of Housing and Mission Goals, would assume all of the responsibilities that are currently under HUD's jurisdiction. Additionally, OFHEO and the FHFB would be abolished one year following enactment of this legislation, and their functions and current staff would be transferred to the Division of Enterprise Regulation and the Division of Federal Home Loan Bank Regulation, respectively, within FHESA. The legislation also would establish an Inspector General within FHESA.

FHESA Fees and Spending. The Director of FHESA would have the authority to assess fees on the housing-related GSEs each year to obtain funding for reasonable costs and expenses associated with FHESA's responsibilities. Such funding would not be subject to the appropriation process. While many of the activities currently performed by HUD, OFHEO, and the FHFB would continue under S. 1508, enacting this legislation also would establish some new authorities, such as the authority to conduct a liquidation of a troubled or insolvent GSE and the authority to increase the amount of capital held by the GSEs to cushion against potential losses.

CBO estimates that FHESA would require annual funding greater than \$75 million—that is approximately the amount that will be spent by the FHFB, OFHEO, and HUD in 2004 to perform current oversight of the GSEs. The bill would create several new responsibilities and strengthen some existing oversight authorities. Based on information from HUD and the FHFB, we estimate that FHESA would assess fees totaling in the neighborhood of \$100 million beginning in 2006 to operate and perform its duties under S. 1508.

In subsequent years, total assessments would increase as the business transactions associated with the GSEs become more complex or if other oversight-related issues arise. In addition, CBO expects that, in most years, FHESA would spend the total amount of fees it collects from the three GSEs in each year. Thus, CBO estimates that enacting the FHESA oversight provisions of S. 1508 would have no significant net effect on the budget in any year.

Other Effects on Spending. Enacting S. 1508 also could further affect direct spending and revenues because this bill would provide for civil and criminal penalties against the GSEs or a party affiliated with them for various violations of law. While enacting the legislation would expand the number of possible violations, CBO has no basis to estimate that the level of fines assessed would significantly increase under the bill. In fact, prior to the large fine paid by Freddie Mac in 2003 (\$125 million) and the amount paid by one of its former employees (\$125,000), no fines had been collected from any of the housing-related GSEs.

Section 108 of the bill would direct GSEs to register their capital stock with the Securities and Exchange Commission (SEC) under the Securities Act of 1934. Registering under this

act involves standardized disclosure of certain financial information but does not include payment of fees associated with other securities laws.

Under current law, GSEs are exempt from registering their capital stock with the SEC. However, Fannie Mae and Freddie Mac are currently registering with the SEC voluntarily, and the FHFB is currently creating regulations that would require the FHLBs to do so as well. Based on information provided by the SEC, CBO estimates that implementing section 108 of S. 1508 would impose no significant costs on the SEC or the GSEs.

Finally, implementing the bill would reduce the need for appropriations to HUD of about \$5 million a year because FHESA would take over HUD's current GSE-oversight responsibilities.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

S. 1508 contains intergovernmental mandates as defined in UMRA, but CBO estimates that the resulting costs would not be significant and would not exceed the threshold established in UMRA (\$60 million in 2004, adjusted for inflation). Section 1367 of title I would preempt state statute of limitation laws and state contract law. Such preemptions are mandates as established in UMRA, but CBO estimates that any costs would fall significantly below the threshold established in UMRA.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

S. 1508 would impose several private-sector mandates as defined by UMRA on Fannie Mae, Freddie Mac, and the FHLBs. CBO estimates that the aggregate direct cost of those mandates would exceed the annual threshold established by UMRA (\$120 million in 2004, adjusted annually for inflation) in each of the first five years the mandates are in effect.

Annual Assessments

The bill would establish a new federal regulator for the GSEs concerned with home mortgages—Fannie Mae, Freddie Mac, and the FHLBs. Under current law, those GSEs pay assessments to their regulators. Under the bill, they would effectively pay higher assessment fees for the operation of their new regulator—the Federal Housing Enterprise Supervisory Agency. Such a requirement would be a new private-sector mandate. According to government and industry sources, Fannie Mae, Freddie Mac, and the FHLBs currently pay

approximately \$70 million in assessments to their regulatory bodies. Under S. 1508, CBO estimates that those GSEs would pay a total of about \$100 million in annual assessments, beginning in 2006. Therefore, the direct cost of complying with the mandate would be approximately \$30 million in 2006 and could increase in subsequent years.

Underserved Market Fund

S. 1508 would establish an Underserved Market Fund to which Fannie Mae and Freddie Mac would be required to contribute. The bill would impose a new private-sector mandate on Fannie Mae and Freddie Mac by requiring them to contribute 2.5 percent of their annual net earnings into the fund to be used to provide grants to address the needs of underserved markets such as rental housing for extremely low-income families. The cost of the mandate would be the amount contributed by Fannie Mae and Freddie Mac. Based on an average of their reported net earnings, CBO estimates that the contribution to the fund for such grants would be approximately \$500 million in 2005. Assuming historical rates of growth in net earnings for those GSEs, the direct cost of the mandate could increase to \$600 million in 2009.

The bill also would require Fannie Mae and Freddie Mac to contribute another 2.5 percent of their annual net earnings to the fund to be used to support new mortgage loan products or increased underwriting flexibility for existing loan products that support the needs of underserved markets. The cost of this mandate would be the amount contributed to the fund less the income generated by Fannie Mae and Freddie Mac using that money to support such a mortgage credit program. The bill would allow the program to include activities involving a reasonable economic return. CBO has no basis for estimating the size of return under such a program. Depending on how it is structured, the cost of the program could be substantially lower than the 2.5 percent of net earnings.

Additional Mandates

Section 108 would require the housing-related GSEs to register at least one class of their capital stock with the SEC under the Securities Act of 1934. Registering under this act involves standardized disclosure of certain financial information but does not include payment of fees associated with other securities laws. Fannie Mae and Freddie Mac are currently registering with the SEC voluntarily. In addition, the Federal Housing Finance Board is currently creating regulations that would require the FHLBs to register as well. Therefore, the direct cost to the GSEs to comply with the mandate would be minimal, if any.

Section 109 would require Fannie Mae and Freddie Mac to disclose to shareholders each quarter the fair value of the shareholders' equity interest in the enterprise. According to industry sources, such information is readily available, therefore, CBO estimates that the direct cost to comply with the mandate would be small.

In addition, section 421 would prohibit Fannie Mae and Freddie Mac from dealing with purchasing, servicing, selling, or dealing in any mortgages that require arbitration. The enterprises have announced that they will stop dealing in mortgages that contain or are subject to a provision that requires arbitration beginning in August 2004. Therefore, the direct cost to the enterprises to comply with this mandate would be minimal, if any.

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